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RUEHAR/AMEMBASSY ACCRA 3010
RUEHDS/AMEMBASSY ADDIS ABABA 3125
RUEHRL/AMEMBASSY BERLIN 1554
RUEHBY/AMEMBASSY CANBERRA 2388
RUEHDK/AMEMBASSY DAKAR 2755
RUEHKM/AMEMBASSY KAMPALA 3173
RUEHNR/AMEMBASSY NAIROBI 5618
RUEHGV/USMISSION GENEVA 2301
RUEAIIA/CIA WASHDC
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UNCLAS SECTION 01 OF 02 HARARE 000712

SENSITIVE
SIPDIS

AF/S FOR B.WALCH
ADDIS ABABA FOR USAU
ADDIS ABABA FOR ACSS
STATE PASS TO USAID FOR J.HARMON AND L.DOBBINS
NSC FOR SENIOR AFRICA DIRECTOR MICHELLE GAVIN

E.O. 12958: N/A
TAGS: ECON EFIN ZI
SUBJECT: ZIMBABWE BANK DEPOSITS GROW BUT LENDING IS TIGHT

¶1. (SBU) SUMMARY: Zimbabwe's banking sector is slowly recovering from the effects of hyperinflation. Public confidence in the sector had sunk to low levels, with people keeping money in pillows rather than depositing it in banks. As confidence improves, the banks are growing again, but they still find it difficult to lend. Following the collapse of the Zimbabwe dollar, the Reserve Bank of Zimbabwe (RBZ) cannot act as lender of last resort, and there is no longer an active interbank market. In order for the banking system to become liquid again in Zimbabwe's newly dollarized economy, there will need to be more investment inflows and greater confidence among depositors. Both will be more likely once sustained economic and political reforms allow Zimbabwe to re-engage with the international financial institutions. END SUMMARY.

Banks Struggle under Hyperinflation

¶2. (SBU) Zimbabwe's commercial banks almost collapsed during the hyperinflation of 2008. Most were technically insolvent, with U.S. dollar liabilities eventually overwhelming assets denominated in the evaporating Zimbabwe dollar. At an August 3 meeting of leading bankers at the Embassy, the Deputy President of the Bankers' Association of Zimbabwe (BAZ), John Mushayavanhu, said the public had lost confidence in the banking system after the RBZ raided foreign currency accounts and imposed very low daily cash withdrawal limits in the face of hyperinflation. When they could not get their funds out of the banks, people started keeping money "under pillows," he said.

Dollarization to the Rescue

¶3. (SBU) Informal dollarization of the economy began years ago and was virtually complete by the end of 2008. But the RBZ was slow to allow transactions in foreign currency. The President of the BAZ, John Mangudya, said dollarization harmed the banks at first because RBZ rules required that fees be charged in Zimbabwe dollars even though banks' costs were predominantly denominated in foreign

exchange. As hyperinflation raged, this generated further losses at most financial institutions. According to Mushayavanhu, only when the RBZ changed the rules in February did the banks start to recover.

¶4. (SBU) According to Mushayavanhu, once the RBZ acknowledged dollarization, total deposits in the banking system began to grow again, rising from about USD 200 million in February 2009 to USD 706 million at the end of June 2009. One reason for this was growing public confidence in the banks. Depositors remain much more cautious than before the hyperinflation, however. Mushayavanhu believes that as much as USD 500 million is still circulating outside the banking sector. Another reason deposits are growing, according to Barclays Managing Director George Guvamatanga, is that an increase in armed robberies had forced a number of people to
Qan increase in armed robberies had forced a number of people to deposit money in banks for the sake of security.

¶5. (SBU) RBZ Governor Gideon Gono's recent call for re-introduction of the Zimbabwe dollar has made the public more cautious about depositing money in banks. Fresh memories of the hyperinflation Gono unleashed with a flood of banknotes create justifiable worries that U.S. dollar deposits in the banks would be forcibly converted and lose value. Even though a reintroduction of the Zimbabwe dollar is a practical impossibility in the near future, Gono likes to "think outside the box."

Lending Stalled

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¶6. (SBU) In its 2009 mid-year monetary policy statement of July 30, the RBZ expressed concern over the banks' low average loan-to-deposit ratio of 37.3 percent as of the end of June, about 30 percentage points lower than before the hyperinflation. Mushayavanhu said banks cannot make large loans over long periods because they must keep significant cash balances to meet the withdrawal requests of depositors, who now tend to turn their funds over more quickly than before. Furthermore, bankers say, without an active interbank market, individual banks must keep more cash on hand because they cannot count on being able to borrow from other banks. With no lender of last resort in the market and the general scarcity in Zimbabwe of dollar-denominated commercial paper to use as security, the banks have largely ceased lending to each other.

¶7. (U) Citing these liquidity constraints, other banking sources confirm that most banks lend on a very short term basis -- 60 days for companies and 30 days for individuals. The consensus view among our banking contacts is that liquidity, not credit risk, is the main obstacle to bank lending in Zimbabwe right now.

¶8. (SBU) In Mangudya's view, lending will improve only when Zimbabwe sees substantial foreign inflows that ease liquidity constraints. While remittances used to help, Mangudya said, little is coming in from Zimbabweans abroad because of the global economic crisis. He did not foresee increased lines of credit until the country normalized relations with the international financial institutions.

COMMENT

¶9. (SBU) Zimbabwe's economic prospects will improve when the banks can get back to lending. That will require liquidity from investment inflows, external lines of credit, and greater confidence among depositors. We expect all of these factors to improve at least marginally in the short run as Zimbabwe's economy crawls back from the depths. But permanent recovery and steady growth in the banking sector will be hard to achieve until the GOZ can re-engage with international financial institutions after clearing arrears and implementing overdue reforms.

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